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In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 418

THE AVIATION CLUB OF UTAH, A CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 17–27) is reported at 7 T. C. 377. The opinion of the Circuit Court of Appeals (R. 151–155) is reported at 162 F. 2d 984.

JURISDICTION

The judgment of the Circuit Court of Appeals (R. 155) was entered on June 30, 1947. By order of this Court dated September 26, 1947, the time within which the petition for a writ of certiorari might be filed was extended for a period of 60 days from that date. (R. 157.) The petition for

a writ of certiorari was filed on October 30, 1947. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether or not the Club was exempt from taxation under Section 101 (9) of the Internal Revenue Code for the years 1942 and 1943.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved in this case are found in the Appendix, infra, pp. 14–18.

STATEMENT

The facts found[1] by the Tax Court (R. 18–23) may be summarized as follows:

The Club is a corporation, without capital stock, organized and existing under the laws of the State of Utah authorizing nonprofit corporations. It was organized on November 15, 1940, by 30 persons, living in or near Salt Lake City, who were interested in aviation. Each of the 30 original organizers loaned the Club $100 at that time for organization expenses and for the initial payment on a residence later purchased as a clubhouse. These loans were repaid by the Club in 1942. (R. 18.)

The purposes of the Club were the promotion of the interest of its members in aviation, the dis-

[1] Any reference to the evidence is made by specific record citation other than pages 18–23.

semination of information pertaining thereto and the providing of cultural, fraternal, social and educational activities for its members, particularly with respect to their interest in aviation. It had no intention to accumulate profits beyond the extent necessary for the Club's existence and no specific intention of distributing any of its profits to its members. Its articles of incorporation provided, however, that upon dissolution any surplus would be divided among the members then in good standing (R. 18) and a 1943 amendment provided that dissolution could take place at any time prior to its stated term of existence (R. 121).

The Club was originally composed of regular members elected by the nominating committee and the board of directors. They alone paid dues, were entitled to vote and hold office and to the privilege of inviting guests to the Club. The members totaled 162 during 1942 and 154 during 1943. The clubhouse was not open to the public. (R. 19–20.) Soon after the Club was organized it recognized "guest members" who were out-of-town friends or associates of regular members. Guest members paid for food and services at the Club at the same rate charged regular members. (R. 20.)

The clubhouse was acquired early in the summer of 1941 and since the Club had no funds with which to furnish it and no experience in the operation of a social club it entered into a con-

tract with one C. LeRoy Jensen to furnish and operate the Club. (R. 18–19.) Under this contract, made in April 1941, Jensen agreed to furnish and equip the clubhouse in exchange for the exclusive right to operate the dining room, a bar and other designated activities. He was to pay the Club a monthly rental and in addition the agreement provided that Jensen and the Club were to divide the profits from the operation of the concessions granted to Jensen. The percentage division of profits in effect from October, 1942, and for all of 1943 were graduated from 60–40 up to 80–20 to the Club. (R. 19.) Jensen was not at the time a member of the Club (R. 19), but his operations were under the direction of Club officials (R. 85–86). The agreement also provided that the Club could acquire the personal property placed in the clubhouse by Jensen and it did so in 1945 by the payment of $28,800 and thereafter operated the Club itself. (R. 19, 22.)

Early in 1942, at the request of Civilian Defense Authorities in Salt Lake City, who were seeking recreational facilities for the entertainment of officer service personnel temporarily in the city, the Club, actuated by patriotic motives, initiated the practice of issuing guest membership cards to male commissioned officers of the armed forces who presented themselves at the clubhouse and requested a card. These officers did not have to be sponsored by a club member. (R. 20.) In

1942 between 3,000 and 4,500 guest cards were issued to officers and between 9,000 and 10,000 during 1943. They had none of the usual prerogatives of membership and were required to pay in advance for all services furnished to them or to ladies accompanying them at the Club. The use of the Club by those officers was so great that regular members were materially restricted in their use of the Club during 1942 and 1943 (R. 20–21), and during those years the Club did not, because of that condition, seek to increase its regular membership (R. 22). The practice of issuing cards to commissioned service personnel was discontinued on VJ-Day. (R. 20.)

Jensen's gross receipts from the operation of the dining room, the bar and other facilities amounted to over $111,600 in 1942 and to more than $268,100 in 1943. (R. 21.) The Club received its share of these amounts. (R. 23.) In 1942 it purchased adjoining property for use as a parking lot and later it endeavored to pay off the balance of $12,493 remaining on its property but could not do so. (R. 22.) In 1943 or early in 1944 it made improvements to the tennis court and purchased for $1,000 an adjacent plot for a swimming pool. (R. 22.)

The Club filed blank returns for the taxable years 1941, 1942 and 1943, claiming exemption from taxes. (R. 18.) The Commissioner determined that the Club was not exempt under Section

101 (9) of the Internal Revenue Code; had net income of $20,750.12 in 1942 and $69,315.08 in 1943, and determined deficiencies (R. 22–23.) Because the returns were not filed within the time prescribed by law penalties were assessed. The deficiencies included income taxes, declared value excess profits taxes, and excess profits taxes. (R. 6.) The Tax Court upheld the exemption for 1941 but sustained the Commissioner's determination for 1942 and 1943. (R. 23.) Upon review the court below affirmed the decision of the Tax Court as to those years. (R. 155.)

ARGUMENT

There is no occasion for further review. The case turns on unique facts and no question of general importance is presented.

1. The case was correctly decided by the Tax Court and the court below. There is no dispute as to the findings of the Tax Court with respect to the Club's operations during 1942 and 1943 and there is no question but that its activities in those years were different from what they were in earlier years. The Tax Court found that the Club had definitely curtailed its operations in behalf of its members for the benefit of a wholly transient clientele and that the change produced profits entirely out of proportion to the income which principal operation for the members had produced (R. 25). These findings are fully supported by the evidence which shows that

during the years 1942 and 1943 any commissioned officer of the Armed Forces could use the Club at his own pleasure, the uniform being the only qualification for his admission. (R. 20.) Despite the admittedly laudable intention of the Club in affording its facilities to officer personnel, these persons were not members of the Club but were an unlimited number of a designated group of the general public insofar as the purpose of the organization was concerned, and only as a result of their use of its facilities were the income and profits of the Club so greatly increased. The Tax Court's final conclusions that the Club engaged in regular commercial acivities resulting in extraordinary profits (R. 21, 25, 154 and 155), and that this substantial business had only an indirect relation to the original purpose for which the Club was organized (R. 27 and 155) have a substantial basis in the evidence and are not open to review. *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231.

In holding that a social club loses its exempt status if its operations are changed from normal club activities into commercial pursuits and that profits resulting therefrom inured to the benefit of the members whether distributed or not, the Tax Court followed principles laid down in the applicable regulations (Section 29.101 (9)–1 of Regulations 111, Appendix, p. 18, *infra*) and in other decided cases. See *Jockey Club* v. *Helver-*

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ing, 76 F. 2d 597 (C. C. A. 2d); *West Side Tennis Club* v. *Commissioner,* 111 F. 2d 6 (C. C. A. 2d), in which this Court denied certiorari, 311 U. S. 674.

The regulation in question denies exemption to a club which engages in traffic for profit. The same provisions were incorporated in Article 101 (9)–1 of Regulations 101, promulgated under the Revenue Act of 1938, and in Section 19.101 (9)–1 of Treasury Regulations 103, promulgated under the Internal Revenue Code.[2] The regulations, therefore, have received legislative approval and have the force and effect of law. *United States* v. *Safety Car Heating Co.,* 297 U. S. 88; *Hassett* v. *Welch,* 303 U. S. 303; *Helvering* v. *Winmill,* 305 U. S. 79, 83; *Boehm* v. *Commissioner,* 326 U. S. 287, 291–292, and compare *Better Business Bureau* v. *United States,* 326 U. S. 279.

The regulation is clearly in accord with the statute which requires not only that the Club be organized exclusively for pleasure, recreation and other non-profitable purposes, but also that it be operated exclusively for such purposes. It is

[2] Earlier regulations were similar except that they either did not contain any provision as to sales of property (see e. g., Article 530 of Regulations 77, promulgated under the Revenue Act of 1932), or provided that where the club sells any of its property at a profit it is not exempt for the year in which the profit is taxable. Article 101 (9)–1 of Regulations 86, promulgated under the Revenue Act of 1934.

therefore immaterial whether the Club's organization or its purposes changed since its operations did change. The fact that exemption exists for one year does not compel the conclusion that it exists for other years (cf. *Jockey Club* v. *Helvering, supra,* and *West Side Tennis Club* v. *Commissioner, supra*) where, despite the fact that the organization is still the same organization nominally, its activities are different.[3]

2. The Club asserts (Pet. 12, 13) probable conflict with the decision of this Court in *Trinidad* v. *Sagrada Orden,* 263 U. S. 578. It quotes a portion of the opinion to show that a quantitative test, which in the sense that petitioner uses the term was not in fact applied by either the Tax Court or the court below, is improper. However, the Club misplaces its reliance upon the statement in that opinion that not the source of income but its destination is the ultimate test of exemption. The statement was made only in connection with the determination of the exclusive operation of

[3] In this connection see Sections 29.101–1 and 29.101–2 of Treasury Regulations 111 relating to proof of exemption where operations change from year to year (Appendix, *infra*). Where a social club has no exemption status for a particular year, it is required to file a return as any other corporation under Section 52 of the Internal Revenue Code (Appendix, *infra*), or for part of a year under Section 29.52–1 of Treasury Regulations 111 (Appendix, *infra*). Moreover, every exempt corporation is required by Section 54 (f) of the Internal Revenue Code (Appendix, *infra*) to file a return for years beginning after December 31, 1942.

the corporation sole in that case for religious purposes. This Court pointed out that the income of the corporation from whatever sources could only be used for those purposes. The statement relied upon thus means only that if all of the income from incidental activities is used for the purposes for which exemption is granted its source is immaterial because the activities are incidental. Since in the instant case the operations of the Club in 1942 and 1943 were extraneous to and were not incidental to the purpose for which the Club was organized the source of the income and profits was material in deciding upon exemption and there is no conflict between the decisions here and that in the *Sagrada Orden* case.

For the same reason, there is no conflict with the decisions in *Santee Club* v. *White,* 87 F. 2d 5 (C. C. A. 1st); *Koon Kreek Klub* v. *Thomas,* 108 F. 2d 616 (C. C. A. 5th); *Coeur D'Alene Country Club* v. *Viley,* 64 F. Supp. 540 (D. Idaho). The income in those cases was from operations incidental to the normal and organizational purposes of the Club. Nor is there conflict with the decisions in *Roche's Beach, Inc.* v. *Commissioner,* 96 F. 2d 776 (C. C. A. 2d), and in *Debs Memorial Radio Fund* v. *Commissioner,* 148 F. 2d 948 (C. C. A. 2d). The statutory basis of the exemption granted in those cases is fundamentally different from the basis of exemption under Section 101 (9) (Appendix, *infra*). In the *Roche's Beach*

case, *supra,* exemption was allowed, under a provision equivalent to Section 101 (6) of the Internal Revenue Code, because the corporation was organized and operated exclusively for charitable purposes. In the *Debs Memorial Radio Fund* case the exemption was allowed, under Section 101 (8) of the Code, because the corporation was an organization not organized for profit and operated exclusively for the promotion of social welfare. In those cases we find the public purpose concept of exemption recognized in *Trinidad* v. *Sagrada Orden, supra.*

Moreover in those cases, as in the *Sagrada Orden* case and the others with which the Club here asserts conflict, the income was from incidental activities and could only be used for the specified organizational purposes. Neither the public purpose aspect of exemption nor the incidental activities feature are present in the instant case and the *Roche's Beach* and *Debs Memorial Radio Fund* cases, *supra,* are not in point in the consideration of exemption for social clubs.

This is clear since those cases were decided by the same court which had decided the *Jockey Club* and *West Side Tennis Club* cases, *supra,* and it apparently saw no conflict in its decisions of cases involving a public purpose with its decisions of cases involving social clubs. In *Sun-Herald Corp.* v. *Duggan,* 160 F. 2d 475, the Circuit Court of Appeals for the Second Circuit said that the

Roche's Beach case held only that the certificate of incorporation was not the only test of whether a corporation was "organized" for educational or other similar purposes under subdivision fourteen.

In the case of *Bohemian Gymnastic Ass'n Sokol of City of N. Y.* v. *Higgins,* 147 F. 2d 774 (C. C. A. 2d), involving the application of social security taxes to a corporation organized exclusively for educational purposes the same court said that if the *Bohemian Ass'n* were a social club its decisions in the *Jockey Club* and *West Side Tennis Club* cases might require it to hold that the receipt of such a large proportion of its income from a bar and restaurant patronized as they were not only by members, but even more by the outside public, the exact situation in the instant case, negatives tax exemption. In that decision the Circuit Court of Appeals pointed out the rationale of its position with respect to the exemption statutes as applied in other cases, which establishes the absence of any conflict between the decisions in the instant case and those in the *Roche's Beach* and the *Debs Memorial Fund* cases.

The case of *Scofield* v. *Corpus Christi Golf & Country Club,* 127 F. 2d 452 (C. C. A. 5th), presents a slightly different situation but there is no conflict of the decisions here with that decision. In that case the contention was made that the club was not exempt under Section 101 (9) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, because

it derived profits from a continuing oil lease upon its property. There was, however, no discontinuance of the usual club operations for the exclusive benefit of its members and the majority of the court distinguished that case from the *West Side Tennis Club* and *Jockey Club* cases on the ground that the club was not engaged in the operations which produced the income. While that case may be said to extend the concept of "incidental" activities of a club to an extreme point the fact that there was no actual change in the operations of the club to produce unusual revenue, and that the club itself did not engage in the operations which produced that revenue are distinctions which are fatal to the assertion of a square conflict with the decisions below in the instant case necessitating review by this Court.

CONCLUSION

The decision below is correct. No question of great public importance is involved and there is no conflict of decisions. The petition should, therefore, be denied.

Respectfully submitted.

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NOVEMBER 1947.

APPENDIX

INTERNAL REVENUE CODE

SEC. 52. CORPORATION RETURNS.

(a) *Requirement.*—Every corporation subject to taxation under this chapter shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe. * * * (26 U. S. C. 1940 ed., Sec. 52.)

* * * * *

SEC. 54. RECORDS AND SPECIAL RETURNS.

* * * * *

(f) [as added by Sec. 117 of the Revenue Act of 1943, c. 63, 58 Stat. 21] Every organization, except as hereinafter provided, exempt from taxation under section 101 shall file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the

approval of the Secretary, may from time to time prescribe. * * *

* * * * *

(26 U. S. C. 1940 ed., Sec. 54.)

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

The following organizations shall be exempt from taxation under this chapter—

* * * * *

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder;

* * * * *

(26 U. S. C. 1940 ed., Sec. 101.)

REGULATIONS 111, PROMULGATED UNDER THE INTERNAL REVENUE CODE

SEC. 29.52–1. *Corporation Returns.*—Every corporation not expressly exempt from tax must make a return of income, regardless of the amount of its net income. In the case of ordinary corporations, the return shall be on Form 1120. * * * A corporation having an existence during any portion of a taxable year is required to make a return. * * *

* * * * *

SEC. 29.101–1 [as amended by T. D. 5381, 1944 Cum. Bull. 188]. *Proof of Exemption Prior to January 1, 1943—Annual Returns for Accounting Periods Beginning Prior to January 1, 1943.*—A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption it is necessary that every

organization claiming exemption file with the collector for the district in which is located the principal place of business or principal office of the organization an affidavit or a questionnaire as set forth below. An organization claiming exemption under section 101 * * * (9), * * * shall file the form of questionnaire appropriate to its activities, filled out in accordance with the instructions on the form or issued therewith. Copies of the following questionnaire forms may be obtained from any collector: For corporations claiming exemption under section * * * 101 (9), Form 1025; * * * An organization claiming exemption under section 101 * * * (9) * * * shall also file with the other information specified herein a return of information on Form 990 relative to the business of the organization for the last complete year of operation; * * *

The words "private shareholder or individual" in section 101 refer to individuals having a personal and private interest in the activities of the corporation. * * *

* * * * *

When an organization * * * has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created, except that every organization exempt or claiming exemption under section 101 * * * (9) * * * shall file annually returns of information on Form 990 with the collector for the district in which is located the

principal place of business or principal office of the organization; * * *

* * * * *

SEC. 29.101 (9)–1. *Social Clubs.*—The exemption granted by section 101 (9) applies to practically all social and recreation clubs which are supported by membership fees, dues, and assessments. If a club engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes. Generally, an incidental sale of property will not deprive the club of the exemption.

SEC. 29.101–2 [as added by T. D. 5381, 1944 Cum. Bull. 188]. *Proof of Exemption on or After January 1, 1943—Annual Returns for Accounting Periods Beginning on or After January 1, 1943.*—(*a*) *Proof of exemption.*—An organization is not exempt from tax merely because it is not organized and operated for profit. In order to establish exemption it is necessary that every organization claiming exemption file with the collector for the district in which is located the principal place of business or principal office of the organization an affidavit or questionnaire as set forth below. An organization claiming exemption under section 101 * * * (9) * * * shall file the form of affidavit or questionnaire appropriate to its activities, filled out in accordance with the instructions on the form or issued therewith. Copies of the following forms may be obtained from any collector: For organizations claiming exemption * * * under section 101 (9), Form 1025; * * *

* * * * *

(*d*) *"Private shareholder or individual" defined.*—The words "private shareholder or individual" in section 101 refer to persons having a personal and private interest in the activities of the organization.

(*e*) *Requirement of annual returns.*—For accounting periods beginning after December 31, 1942, every organization exempt from tax under section 101, regardless of the amount or source of its income or receipts * * * shall file annually with the collector * * * a return of information on Form 990 (revised May, 1944) specifically stating the items of gross income, receipts, and disbursements and such other information as may be prescribed by the Commissioner * * *.

* * * * *

(*j*) *Records, statements, and other returns of tax-exempt organizations.*—An organization which has established its right to exemption from tax under section 101 * * * shall immediately notify in writing the collector for the district in which is located its principal office of any changes in its character, operations, or purpose for which it was originally created.

* * * * *

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